

ANALYSIS OF ORIGINAL BILL

Author: Price Analyst: Matthew Cooling Bill Number: AB 462
 Related Bills: See Legislative History Telephone: 845-5983 Introduced Date: February 24, 2009
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: College Affordability Act Of 2009/Impose Additional 1 Percent Tax On Taxable Income In Excess Of \$1 Million

SUMMARY

This bill would impose an additional 1 percent tax on taxable income in excess of \$1 million, as specified.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to increase college enrollment by freezing college tuition and fees at the California State University and the University of California for five years.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2010.

POSITION

Pending.

ANALYSISFEDERAL/STATE LAW

Federal tax law imposes six different personal income tax (PIT) rates on individuals ranging from 10 percent to 35 percent. Newly enacted state tax law (Evans, Stats. 2009, Third Extraordinary Session, Ch. 18) temporarily adds 0.25 percent to each PIT rate for taxable years 2009 and 2010. As a result, current state tax laws impose six different income tax rates on individuals ranging from 1.25 percent to 9.55 percent. Each PIT rate applies to a different range of taxable income known as a "tax bracket." Existing state law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CCPI).

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <input checked="" type="checkbox"/> PENDING

Department Director

Date

Selvi Stanislaus

05/27/09

For taxable years beginning on or after January 1, 2005, California law imposes an additional 1 percent Mental Health Tax (MHT), not subject to reduction by credits, on the portion of taxable income that exceeds \$1 million for taxpayers subject to tax under the Personal Income Tax Law (PITL). The taxable income threshold of \$1 million is not indexed based on changes in the CCPI. The MHT is subject to estimated tax payment requirements, interest, penalty, and other tax administration rules because it is treated the same as the PIT imposed under existing law.¹

THIS BILL

For taxable years beginning on or after January 1, 2010, this bill would impose an additional 1 percent tax on taxable income in excess of \$1 million for taxpayers subject to tax under PITL. This tax, combined with the existing MHT, could effectively create an 11.55 percent tax bracket for individuals, estates, and trusts with taxable income in excess of \$1 million.

The additional tax imposed by this bill would not be reduced by tax credits or be subject to estimated tax payment requirements because it would not be considered a tax imposed by Revenue & Taxation Code (R&TC) section 17041. In addition, the \$1 million threshold for imposition of the tax would not be annually indexed based on changes in the CCPI.

This bill would also establish the College Affordability Fund within the State Treasury upon enactment. The revenue from this tax would be deposited into the General Fund of the State Treasury. Sixty percent of the revenue collected through this tax will be deposited into the College Affordability Fund and continuously appropriated to the California State University and the University of California to offset increased costs of educating resident undergraduate students, as specified. The remaining 40 percent would remain in the General Fund.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill fails to specify a transfer schedule or funding mechanism to address how and when the revenue generated from this additional tax would be identified and transferred from the state's General Fund to the College Affordability Fund. Without clear direction, identifying the amount of revenue attributable to the additional tax imposed by this bill and the timing of transfers of the revenue to the College Affordability Fund could be problematic and costly. To facilitate FTB's administration of this bill, the author may wish to consider the provisions of R&TC section 19602.5, enacted as a result of Proposition 63, which provides estimates of revenue and a detailed calculation and transfer rate of the MHT.

In addition, administrative uncertainties exist because the additional tax imposed by this bill would not be treated as a tax imposed under R&TC section 17041. As a result, department staff has indicated that there would be significant system and procedural changes that would be made to collect the tax proposed by this bill. The author may wish to consider adding language that would treat the additional tax imposed by this bill as a tax imposed under R&TC section 17041.

¹ Revenue and Taxation Code sections 17041 and 17043

This bill fails to specify the tax treatment for married couples filing separately. This could complicate the administration of this tax and lead to disputes between the department and taxpayers. The author may wish to specify how married couples filing separately would report this tax.

This bill uses the undefined term “resident undergraduate statewide mandatory fee.” It is unclear if the residents are residents of the university or residents of the state of California for university fee purposes. It is recommended that the author amend this bill to clarify the definition of this term.

LEGISLATIVE HISTORY

ABX1 2 (Evans, 2009/2010) would have imposed an additional tax on all personal income taxpayers equal to 2.5 percent of the taxpayer’s total tax, as defined. This bill was vetoed by Governor Schwarzenegger. Please see attachment for veto message.

ABX3 3 (Evans, Stats. 2009, Ch. 18) temporarily added 0.25 percent to each PIT rate for taxable years 2009 and 2010. If certain notification regarding funds related to the federal stimulus act is given by the Director of Finance on or before April 1, 2009, then 0.125 percent will be added to each PIT rate.

SB 13 (Hollingsworth, 2009/2010) would reduce existing PIT rates over a five-year period to zero, repeal the alternative minimum tax at the end of that five-year period, repeal the 1 percent MHT imposed on taxpayers with taxable income in excess of \$1 million dollars (upon voter approval), and change the method for taxing non-residents and part-year residents. This bill has been referred to the Senate Revenue and Tax Committee.

SB 96 (Ducheny, 2009/2010) would modify and add PIT rates of 9 percent, 9.5 percent, 10 percent, 10.5 percent, and 11 percent and would increase the alternative minimum tax rate for PIT taxpayers to 8.5 percent. This bill is currently in the Senate Revenue and Taxation Committee.

AB 1443 (DeVore, 2007/2008) would have reduced the highest PIT rate from 9.3 percent to 9.25 percent and would have reduced the highest Corporation tax rate from 8.84 percent to 8.79 percent. This bill failed to pass out of the house of origin by the Constitutional deadline.

AB 2372 (Coto, 2007/2008) was identical to this bill and failed to pass out of the Assembly Appropriations Committee.

ACA 24 (Cohn, 2005/2006) would have imposed an additional tax at the rate of 1/40th of 1 percent on taxable income in excess of \$1 million to fund domestic violence shelter services. This constitutional amendment failed to pass out of the house of origin by the constitutional deadline.

Proposition 82 would have imposed an additional 1.7 percent tax on taxable income in excess of specified threshold amounts. The additional revenue would have been used to provide funding for preschool programs. This initiative failed to pass during the June, 2006, Primary election.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, Massachusetts, and Michigan impose a flat tax of 3 percent, 5.3 percent, and 4.35 percent, respectively; *Minnesota* and *New York* have a progressive tax rate and impose a maximum rate of 7.85 percent and 6.85 percent, respectively. *Michigan* imposes a tax rate from 3.9 percent to 4.35 percent for taxable years beginning on or after October 1, 2007.

FISCAL IMPACT

This bill would require additional administrative and system programming costs to manage the transfer of funds, as discussed above. The additional costs will be identified and, if needed, an appropriation requested as the bill moves through the legislative process.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Estimated Revenue Impact of AB 462 Effective for Tax Years Beginning On or After 1/1/2010 Assumed Enactment Date After 6/30/09 (\$ in Millions)			
	2009-10	2010-11	2011-12
General Fund	\$340	\$930	\$940
College Affordability Fund Transfer			-\$500-
Net Impact to General Fund	+\$340	+\$930	+\$440
Behavioral Impact to the Mental Health Services Fund	+\$2	-\$29	-\$18

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would depend on the amount of taxable income reported by individual taxpayers that exceeds \$1 million. This estimate assumes that the additional tax would be imposed on each tax return, regardless of filing status.

The MHT that imposes a 1 percent tax on the portion of taxable income that exceeds \$1 million generated approximately \$1.34 billion for taxable year 2006. Growing that number by Department of Finance projections results in increased revenues of approximately \$1.04 billion for taxable year 2010. Because this bill would not limit the proposed 1 percent tax to timely filed returns, this estimate includes revenue associated with the filing of amended returns and audit assessments. Amended return and audit revenue associated with taxable year 2010 is assumed to be collected over a three-year period with collections beginning in 2012.

To the extent possible, taxpayers are anticipated to alter their behavior by changing their tax planning strategies. It is anticipated that some taxpayers may delay transactions that would generate capital gain income, alter their current level of compliance, or change their business filing status from a sole proprietorship to a corporation to benefit from the lower corporate rate. Based on an analysis of tax return data and relevant economics literature, it is estimated that these behavioral impacts would reduce the estimate for taxable year 2010 by approximately 10 percent to \$936 million [$\$1.04 \text{ billion} \times (1 - 10\%)$]. It is also anticipated that some taxpayers may respond in anticipation to the proposed law and accelerate capital gain transactions, and would realize income during taxable year 2009 that would otherwise have been realized during taxable year 2010. This behavioral response shifts approximately \$90 million from taxable year 2010 to 2009. After making these adjustments, the impact for taxable year 2010 is estimated to total approximately \$846 million (\$936 million - \$90 million).

The estimates in the table above have been adjusted to reflect the cash flow impact. The estimated impact for fiscal year 2009-10 includes the combination of revenue accelerated to taxable year 2009 and anticipated changes in estimated tax payments for taxable year 2010.

The bill fails to specify when revenue would be transferred to the College Affordability Fund. Therefore, it is assumed that the first transfer would be made in January 2011, three months after the 2010 taxable year extension filing date, when data on the amount of tax assessed is available.

POLICY CONCERNS

Taxpayers subject to tax under the PITL who have taxable income in excess of \$1 million are currently subject to the 1 percent MHT. The provisions of this bill would subject the same income to an additional 1 percent college affordability tax.

Funding based on additional taxes imposed on high-income taxpayers creates uncertainty because the amount of income reported by high income taxpayers is volatile.

LEGISLATIVE STAFF CONTACT

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Attachment

BILL NUMBER: ABX1 2
VETOED DATE: 01/06/2009

January 6, 2009

To the Members of the California State Assembly:

I am returning Assembly Bill X1 2 without my signature because it is part of a bill package that does not deal with California's current budget and economic crisis. This bill package punishes Californians by raising revenue without providing permanent and ongoing cuts, does not create jobs or stimulate our economy, does not allow government to run more efficiently in California, and makes no attempt to keep people in their homes.

Sincerely,

Arnold Schwarzenegger